

**NEW ZEALAND**

# **RADAR**

**FY2023**

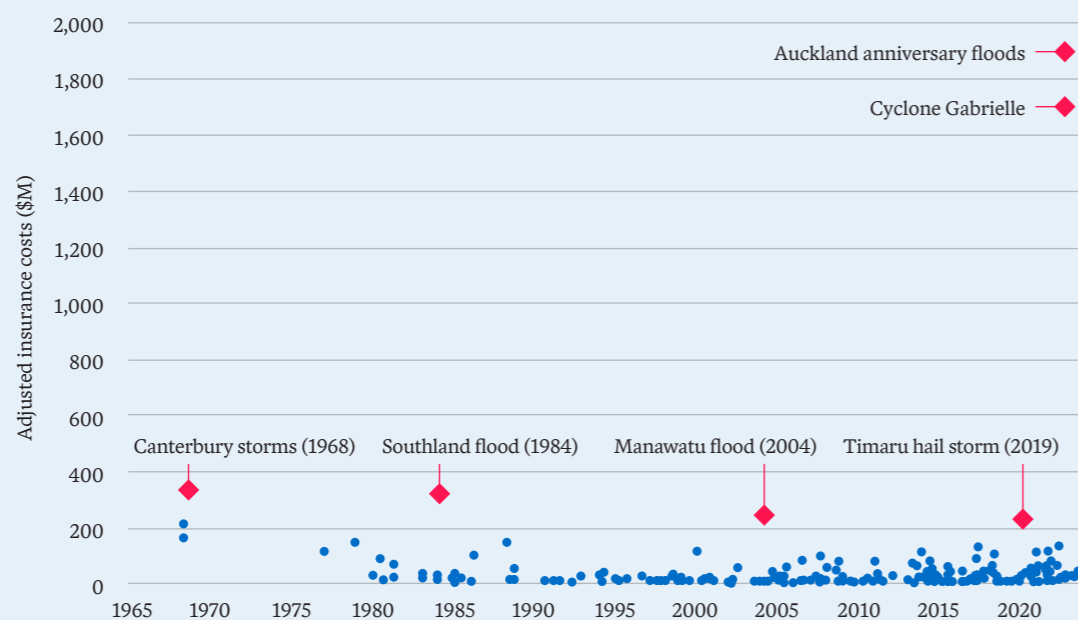
**SNAPSHOT**

Affordability and a shifting regulatory environment – including upcoming ESG obligations – are dominating industry experience across the nation. Amid uncertainty and a mercurial landscape, we dive into the detail and draw out critical insights to help insurers chart a steady path forward.

# General Insurance update 2023

Natural disasters have once again been the main headline for the NZ general insurance industry. However, the Auckland floods in late January and Cyclone Gabrielle in early February have been on a scale never seen before in Aotearoa. Previously, the largest weather-related insurance losses, adjusted for inflation and increases in exposure, have been less than \$400 million. In contrast, claims costs for both events have already exceeded \$1.5 billion.

## Historical weather-related insurance losses\*



\*Excluding EQC payments, adjusted for inflation and exposure

Source: ICNZ for historical losses, Stats NZ for inflation and exposure data



## Introducing categories of risk

The two early-2023 events – Auckland’s floods and Cyclone Gabrielle – have accelerated the discussion around managed retreat from high-risk locations, which was previously outlined in the National Adaptation Plan released by the Government in August 2022. Following the events, the Government announced a [Land Categorisation framework](#). Under this framework, properties classified as Category 3 are not considered safe to live in due to flooding risk and will be offered a [buyout funded by central and local government](#). Properties categorised as Category 2 are considered managed risks, which will require flood protection measures to reduce the risks faced by the properties.

Insurers have already stated [Category 2](#) properties may see [changes in their insurance](#) policies on renewal that will reflect the [future risks from severe weather events](#). This is likely to result in significant increases in insurance premiums, or high levels of excess for losses arising from flooding. In Australia, the introduction of risk-based pricing has resulted in some risks becoming uninsurable. The introduction of the Cyclone Reinsurance Pool last year aims to improve insurance affordability in northern Australia.

## A framework for the future?

The land categorisation framework is specific to the two events and follows the red zone categorisation applied in Christchurch following the 2011 earthquake. It remains to be seen whether similar frameworks will be applied to future events, and if so at what level an event will need to be before the framework is applied. However, it does indicate a willingness of government to improve Aotearoa’s exposure to weather events through a combination of mitigation and managed retreat approaches.



## Unexpected gains

The Reserve Bank (RBNZ) noted in its [May Financial Stability Report](#) that it expected property insurers to record an aggregate loss in the current financial year due to the size of the events. Since then, however, [IAG](#), [Suncorp](#) and [Tower](#) have all announced profits, albeit reduced from previous years due to the impact of the two weather events. While this suggests reinsurance programs have helped insurers maintain profitability, the magnitude of these events has seen reinsurers look to increase the amount of risks assumed, or 'retained', by local insurers before their reinsurance cover begins.

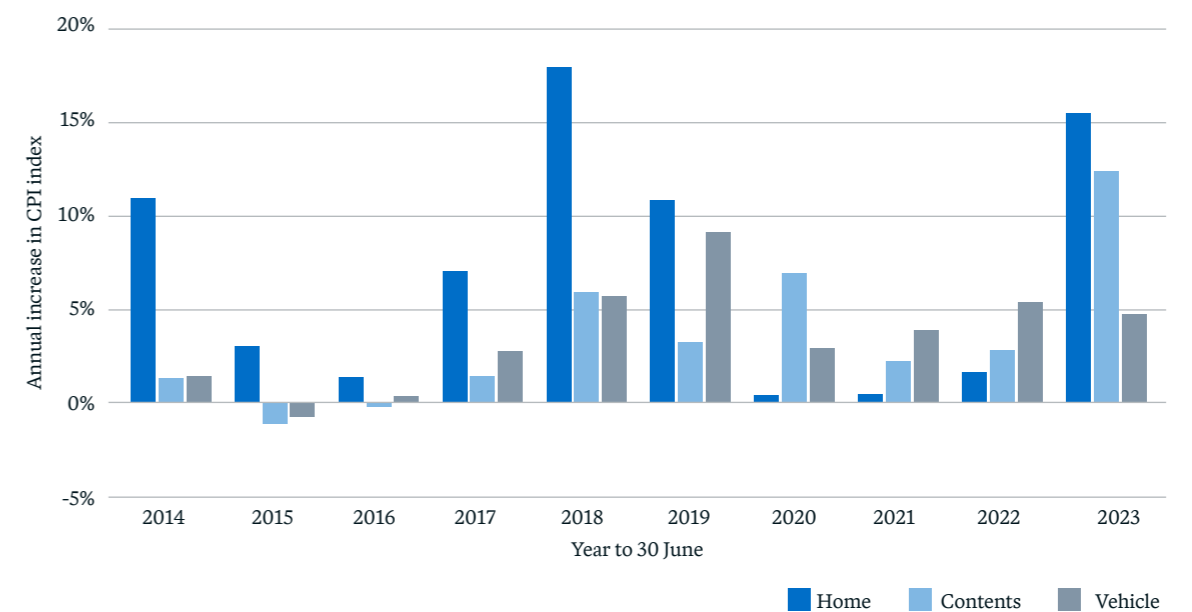
In addition to higher retention levels, the price of reinsurance is also rising, as reinsurers increase their rates to reflect an increasing frequency of weather-related claims internationally. An increased understanding of the nature of New Zealand earthquake risks, as highlighted by the new National Hazard Seismic Model, will also be putting upward pressure on New Zealand reinsurance costs, although this will be partially offset by the increase in the EQC cap to \$300,000 which has now been fully implemented.

## Further premium hikes for consumers

These escalating costs along with the high inflationary environment are likely to result in continuing growth in the cost of insurance. In announcing its recent half-year results, [IAG signalled an expected rate increase](#) in New Zealand of around 20 per cent for motor insurance and 20 to 30 per cent for home.

Inflation data from Stats NZ shows home and contents insurance costs have increased by more than 10 per cent over the year to 30 June 2023. We expect costs to continue to rise over the short term, similar to the increases observed from 2017 to 2019, when home insurance prices rose following the 2016 Kaikoura earthquake.

## Annual increase in consumer price index for personal lines insurance classes



Source: Stats NZ

## Retention, solvency and the domino effect

The increase in reinsurance retention levels will also mean an increase in the minimum solvency requirements for most insurers. Under the RBNZ's solvency standards, the minimum capital insurers are required to maintain increases as their net risk exposure increases. Insurers maintain capital levels above the minimum level required by the RBNZ – so, as the minimum level increases, insurers will need to increase their capital positions to maintain their margin.

This means insurers must either increase their retained earnings by reducing dividends or look at other capital-raising options. Potentially, this may result in some smaller insurers with less access to capital exiting from the New Zealand market in the next few years.

# Spotlight on regulation

The industry is facing a raft of change. In particular, the Reserve Bank and the Financial Markets Authority are firmly focused on general insurance, in response to a rapidly evolving marketplace. We outline the latest developments and what it all means for insurers.

The Reserve Bank (RBNZ) is reviewing its *Solvency Standards* and the underlying *Insurance (Prudential Supervision) Act (IPSA)*. The current Interim Solvency Standard (ISS) issued by RBNZ has mainly been revised to reflect the accounting changes insurers are now implementing – as they transition to the new IFRS 17 accounting standard for reporting periods commencing from 1 January 2023.

The ISS includes a new capital charge for operational risk, which increases the minimum solvency position for insurers, although this charge will be gradually introduced over the next three years. The RBNZ will be reviewing the calibration of the capital charges in the second stage of the solvency standard review, expected to be undertaken in 2025.

## More proactive and intensive supervision of insurers

Progress on RBNZ's review of IPSA is also continuing, with consultation currently being sought on the full set of proposals RBNZ is considering in the amendment of IPSA. The main theme of the review is enabling more proactive and intensive supervision of insurers by the RBNZ, and there are several proposed changes being considered.

It's likely a ladder of intervention will be introduced in the changes, which will enable the RBNZ to escalate its supervisory response as an insurer's level of capital declines. The exact mechanisms of how this would be applied are not yet established, with the RBNZ expecting to produce an exposure draft on the proposed changes in 2024/25.

## On the lookout for options from the ladder of intervention

The changes will then need to go through the parliamentary process to enact the new legislation, which is expected to be completed in 2025/26. The introduction of a ladder of intervention approach may mean insurers will look to increase the level of buffer between their actual capital and the minimum levels at which regulatory action begins. As we mentioned earlier, this may see insurers needing to look at capital-raising options, as the details of revisions to both IPSA and Solvency Standards are released.

## COFI anyone? Fair conduct high on agenda

Further stepping up regulatory requirements, in July this year, the Financial Markets Authority (FMA) opened licence applications under the Financial Markets (Conduct of Institutions) Amendment Act (COFI). To be licensed, insurers will need to prepare and implement a fair-conduct program. COFI also requires insurers to comply with sales incentives regulations that ban target-based sales incentives. The COFI regime will come into force from 31 March 2025.

## Great customer expectations

In addition, the [FMA recently filed proceedings](#) against AA Insurance for failing to correctly apply multi-policy, membership and no-claims-bonus discounts to customer premiums. In October, [Vero Insurance was fined \\$3.9 million](#) by the High Court following FMA proceedings for failing to apply multi-policy discounts. These cases highlight the need for insurers to ensure their processes and systems are functioning correctly and are consistent with their customers' expectations.

The FMA has recently opened consultation on a proposed guide outlining how it will approach outcomes-focused regulation and what this will mean for all providers of financial products and services. This guide promotes a focus on outcomes, with financial product providers expected to take ownership of outcomes. Submissions on this consultation close on 1 March 2024.

## Cyber resilience front of mind

Unsurprisingly, given the number of cyber incidents making the headlines, ensuring financial entities are cyber resilient is front of mind for the RBNZ. Working closely with the FMA, the RBNZ consulted on two key components to improve the collection of cyber-related information in the middle of the year:

- *Cyber incident reporting* – A requirement to report all material cyber incidents to the RBNZ as soon as practicable, but within 72 hours and to report all cyber incidents
- *Cyber capability survey* – A periodic cyber-resilience survey about organisation capabilities (six monthly for large entities; annually for others).

The insurance industry expressed several concerns with the proposal, including that a central repository of cyber security data on financial institutions is itself a cyber risk, and that the threshold of a 'cyber incident' is too broad and would require entities to report even minor incidents – which would be unnecessarily time and resource intensive.

Consultation has now closed, and government agencies are considering feedback in line with any new guidance that may emerge from the recently elected government.

## Key considerations for decision-makers

- Affordability is fast becoming a significant issue for the insurance industry. As insurers improve their understanding of the risks they underwrite, they'll need to work with the government and reinsurers on the most cost-efficient ways to mitigate and protect against these risks.
- Regulation of financial services is rapidly advancing, which will increase compliance costs. It's crucial the insurance sector actively engages in ongoing consultation to ensure regulation provides an appropriate balance between providing protection to the public and the associated cost.
- Continual evolution is vital in this highly changeable environment. It will be key in responding effectively amid rapid change and emerging risks, and in helping insurers remain a sturdy pillar within Aotearoa's financial risk management system.

The wave of upcoming standardised Environmental, Social and Governance (ESG) reporting disclosures represents the biggest changes to financial reporting and disclosure standards in a generation. We break down the climate disclosure regime and explore the new changes on the horizon.

# Spotlight on ESG & sustainability reporting

New Zealand's largest insurers are part of the global climate-disclosure vanguard, required to provide their climate-related disclosures (CRDs) for reporting periods on or after 1 January 2023. This is your climate disclosure cheat sheet, with all your pressing questions answered on the current state of play ...

## Year zero – Reporting kicks off

Climate reporting entities (CREs) under the *Financial Markets Conduct Act 2013* are required to report under three climate-related disclosures standards. This applies to New Zealand's most economically significant entities: those with large, listed debt or equity issues; large financial entities, such as registered banks, licensed insurers, credit unions and building societies; and managers of registered managed investment schemes.

For insurers, this captures all licensed insurers with greater than \$1 billion in total assets or annual premium income greater than \$250 million.

## What standards do entities need to report against?

CREs must report against three New Zealand Climate Standards (NZ CS) – based on the Taskforce for Climate-related Financial Disclosures (TCFD) recommendations. These were released by the External Reporting Board (XRB) in December 2022, and have been designed as a package:

- **NZ CS 1 Climate-related Disclosures** – Contains the climate-related disclosure requirements for each of the TCFD four thematic areas (governance, strategy, risk management, and metrics and targets) and the assurance requirements for greenhouse gas emissions disclosures
- **NZ CS 2 Adoption of Aotearoa New Zealand Climate Standards** – Provides optional adoption provisions
- **NZ CS 3 General Requirements for Climate-related Disclosures** – Contains the principles, underlying concepts such as materiality, and general requirements.

Reporting requirements are being phased in and, in the second phase (accounting periods ending on or after 27 October 2024), elements of the disclosures relating to greenhouse gas emissions will be required to have independent assurance.



## How do these standards compare with international standards?

New Zealand's release of standards pre-dates international consensus on climate reporting by about six months. In June 2023, the International Sustainability Standards Board (ISSB) issued its initial IFRS Sustainability Disclosure Standards:

- IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information*
- IFRS S2 *Climate-related Disclosures* (aligned with TCFD principles).

Given stakeholders' interest in being internationally aligned on disclosures (especially to allow New Zealand entities to competitively participate in global markets), the XRB published a comparison document in October 2023, *Aotearoa New Zealand Climate Standards and IFRS Sustainability Disclosure Standards*. While overall there was a strong degree of alignment in concepts, general requirements and the core content – i.e. both require entities to report on disclosures for governance, strategy, risk management, and metrics and targets – there were many differences. This means if an entity applies IFRS standards it will not necessarily comply with NZ CS, and vice versa.

The XRB recommends entities work through the requirements of each standard, and apply them to their own specific facts and circumstances.

## How will the reporting obligations be regulated?

The Financial Markets Authority (FMA) is responsible for independent monitoring and enforcement of CRDs, as well as providing guidance about compliance expectations, and reporting on its monitoring activities and findings.

The FMA has stated its approach to CRD will evolve over time. For now, it's focused on setting expectations for CREs to support compliance and encourage development of good practice. To date, regulatory guidance has been provided on scenario analysis, keeping proper CRD records, and the use of third-party information providers.

Over 2023/24, the FMA will take enforcement actions only where there has been serious misconduct, such as failure to produce a climate statement, or where a climate statement is false or misleading. Over 2024/25, the FMA will shift to supporting the development of best-practice compliance. For this, it anticipates updating its guidance on compliance expectations in line with maturing sector capability and emerging good practice. From 2026 and beyond, the FMA aims to settle into its 'steady state' level of monitoring and enforcement.

## Key considerations for decision-makers

- There is growing international movement for CRDs from medium-sized entities (including from across the Tasman). Those insurers not currently defined as CREs should consider applying CRD principles to their operations to meet stakeholder expectations and ensure their businesses are as climate-change resilient as possible.
- For CREs, it's important to consider the potential impact of climate-related matters in their financial statements, not just in their CRDs. Be sure to check out guidance the XRB released in November 2023, *Climate-related matters in financial statements*, on this topic.

## Shape of things to come – Other ESG obligations ahead

Businesses – including insurers – will face a host of further obligations coming their way – and they'll need to be prepared. Here's what to watch out for and practical steps to building a strong reporting foundation ...

### Nature-related financial disclosures

In September 2023, the **Taskforce on Nature-related Financial Disclosures (TNFD)** published its final 14 Recommendations and a suite of additional implementation guidance – the culmination of a two-year consultative development process (including pilot testing by more than 200 companies and financial institutions).

The Recommendations build on those of the Taskforce on Climate-related Financial Disclosures (TCFD) – requiring entities to disclose under the same four conceptual pillars of governance, strategy, risk and impact management, and metrics and targets. They're also consistent with the global sustainability standards of ISSB.

While initially reporting under the TNFD will be voluntary, the market is signalling it's likely to be embedded into regulatory and accounting frameworks, and most likely on a faster scale than the TCFD.

Across the Tasman, the Insurance Council of Australia (ICA) is building awareness and knowledge towards an industry position on nature risk.

In the same month the TNFD released its final recommendations, the ICA released the report *Valuing Nature for a Resilient Future*, aimed at assisting the insurance sector to prepare for the TNFD. The report explores the links between insurance and nature, and outlines practical steps insurers can take to start integrating TNFD reporting into their own reporting and business strategies, including:

- Developing insurance products that protect natural assets like coral reefs and coastal defences
- Investment in natural resilience solutions, such as wetland restoration and reforestation
- Working with government and other stakeholders to develop policies that protect nature.

## Modern slavery and worker exploitation supply-chain reporting

Following consultation in 2022, the Government announced in July that organisations with more than \$20 million in revenue will be required to report and outline the actions they take to address modern slavery risks in their operations and supply chain. Modern slavery is defined by the Ministry of Business, Innovation and Employment as severe exploitation that a person cannot leave due to threats, violence or deception. It includes forced labour, debt bondage, forced marriage, slavery and human trafficking.

Given the National Party's reiteration of its support for the legislation, it's expected the introduction of modern slavery legislation in some form will proceed even with the change of government. Reporting obligations could apply from FY2025, at the earliest.

New Zealand reporting obligations will likely be broadly similar to those in Australia, which will be a relief to New Zealand insurers with Australian parent companies. Some insurers with Australian parent companies are already beginning to implement policies and procedures to align with Australian practice. This includes implementing Supplier Codes of Practice clauses (which cover human rights and modern slavery) when renewing contracts with claims suppliers.

## Ngā pou o te kawa ora – Non-financial reporting from an Aotearoa New Zealand perspective

The External Reporting Board (XRB) is currently developing a non-financial reporting framework for Aotearoa New Zealand. This framework will be voluntary, and is being produced to increase transparency and provide entities with a consistent and comparable way of reporting non-financial matters – the economic, environmental, social and cultural impacts, caused by an entity's activities.

The XRB is in the process of finalising a BETA version internally, and is aiming to test this with technical advisers before the end of 2023.

### Key considerations for decision-makers

- Many reporting obligations will be complex and require additional specialised expertise and the participation of businesses across an insurer's supply chain. By planning in advance, insurers will ensure they have the right skills and capabilities to meet their growing reporting obligations.
- Early adoption of voluntary nature-related disclosures may be strategically beneficial for insurers, particularly in response to growing stakeholder expectations.

# Meet our Authors



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Win-Li leads our general insurance practice, harnessing more than 25 years advising insurers, self-insurers and government across the globe, with a special focus on cybersecurity. She holds several Appointed Actuary roles and is 2023 Vice President of the Actuaries Institute of Australia.

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